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THE GAO--HOW ITS WORK AFFECTS LOCAL GOVERNMENT

I am very appreciative of the opportunity to talk to this large gathering of municipal financial officials. We in the General Accounting Office (GAO) have enjoyed a long and constructive relationship with your organization, and I know that we have benefited many times from the counsel of your officers, committees, and many of your members.

Don Beatty told me of your interest in the Standards for Audit of Governmental Activities which we published last year and asked me to discuss the audit standards this morning. I am sure that you also have an interest in two other areas in which we are active, so I plan to comment also on our plans and responsibilities regarding general revenue sharing and our other activities in intergovernmental relations.

GAO is directly involved in many efforts to help strengthen and improve the quality of performance of Government programs. Under the federal system of government today, it is no longer possible to clearly divide the responsibilities of each level of government or for the various levels of government to work independently. To satisfactorily carry out the various programs designed to improve the quality of American

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life, Federal, State, and local governments must work together and learn from each other.

DEVELOPMENT OF AUDITING STANDARDS

Most of you are aware that, about a year ago, we issued a booklet entitled "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions." A principal objective of the standards was to stimulate State and local governments to improve the character and quality of auditing and evaluation of federally assisted programs. It is generally agreed that the Federal Government should rely to the extent practicable, on audits made by State and local governments. We are interested, therefore, in reducing the audit workload of the Federal Government and eliminating duplicate audit coverage.

These standards were developed over a period of almost 3 years with the assistance of the Municipal Finance Officers Association, other professional associations, and public interest groups that had an interest in governmental auditing. The acceptance of these standards by State and local governments and the Federal departments and agencies has, from all indications, been substantial.

The scope of audits contemplated in our standards is perhaps the area of greatest interest. Many members of the public accounting profession have asked why we considered it necessary to publish auditing standards when the American Institute of CPAs has had widely accepted auditing standards for

many years and has a committee continually at work on this subject.

Let me assure you that we in GAO are well aware of the institute's standards. However, we have found that, for a number of reasons, the institute's standards do not provide for auditing of the scope we find necessary for Government operations.

Insofar as audits of financial statements are concerned, the institute's standards are quite satisfactory, and we intend for our own standards for such audits to be consistent with them. However, this is only one of several objectives of auditing that need to be considered in performing governmental audits.

In business, profit is the commonly recognized standard of accomplishment. Hence financial results of operation are often considered reasonable demonstrations of effectiveness. Governments, on the other hand, have almost no concern with profitmaking. Their objectives are varied, but generally they deal with promoting the safety, health, and welfare of their citizens. Therefore measures of the effectiveness of Government activities must focus on what the programs are intended to achieve and what they actually achieve.

Moreover, since such programs are financed with taxpayers' funds, there is an accompanying need to know whether funds are properly safeguarded from loss, whether laws and regulations to govern the funds are followed, and whether those who spend

the funds duly consider efficiency and economy in carrying out their work. Responsible government officials must be held accountable in all these areas.

Our auditing standards therefore provide for audits of a broad scope. For convenience we describe the desired scope of audit work in three categories: (1) auditing financial operations and compliance with laws and regulations, (2) reviewing efficiency and economy, and (3) evaluating program results.

QUESTIONS ABOUT STANDARDS

The issuance of the standards providing for these broader scope audits has created much interest on the part of State and local governmental officials as well as by the auditing community itself. A number of questions have been raised repeatedly. Specific questions which we have heard often and on which I would like to express my views are:

1. Is the auditor stepping out of his area of competence when he attempts to audit specialized functions? Or a similar question like: Can CPAs conduct the broad-based audits called for by the audit standards?
2. Are auditors expected to express an overall opinion on whether the organization audited is efficient and economical or on whether the programs were effective?
3. Must efficiency-economy and program effectiveness audits be conducted annually of all phases of Government operations?
4. Will these broad-based audits cost more than the traditional financial audits? If so, how can they be justified?

CAPABILITY TO MAKE BROAD-SCOPE AUDITS

In recent years GAO, which has had an extremely broad character of audit authority and responsibility since its creation

over 50 years ago, has devoted more and more effort to reviewing the efficiency and economy of Government operations and to evaluating the results--the costs and benefits--of Government programs. This expansion of the art of auditing has been based in large part on the direct interest of the Congress--and to some degree the public--in what is being accomplished through Federal programs.

Evaluations of Government activities and Government program results is an art about which all of us have much to learn. There are many difficulties in making such assessments, particularly in the social action areas. However, we are progressing, and in the process we are learning how to make these evaluations more useful. Several factors are involved in improving our performance and capability.

1. We are learning much by doing--through experience.
2. We have been building an interdisciplinary staff of engineers, economists, mathematicians, and other disciplines, as well as accountants.
3. We are making extensive use of expert consultants in various fields and by contracting work out to a limited degree.
4. We are conducting advanced training programs and holding special seminars on program evaluation in specific areas.
5. Increasingly we are taking advantage of analytical and evaluation work of other Government agencies and non-government organizations, such as the Urban Institute and the Brookings Institution.

We believe that, with proper training, auditors of State and local governments and CPAs can also do much to improve the quality of Government programs.

We have already seen evidence of work done by CPA firms in the areas of efficiency and program results. In North Dakota the legislative analyst and auditor engaged two CPA firms to conduct operational audits of two State programs. Similar work has been done by Montana and by Illinois--where 90 percent of the audits are done by a corps of 65 CPA firms. The Illinois auditor general has required that efficiency-economy aspects be included in the scope of those CPA audits.

Audit opinions

One aspect of expanded auditing of governmental operations that I would like to specifically comment on is the stating of audit opinions. I understand that stating overall audit opinions on other than accounts and financial statements gives concern to a great many practicing public accountants. Perhaps this concern is justified, but let me point out that we do not expect the conventional type of auditor's opinion to be rendered on the other aspects of an audit.

Providing an overall opinion on whether the organization audited is efficient and economical, for instance, is neither necessary nor economical. But an auditor can still do much constructive work and provide useful information without expressing such an opinion. We look to the auditor to include in his report the factual information he finds with respect to the activity he has examined, the conclusions he reaches, and any recommendations he may have for improvement.

The type of reporting we look for is not greatly different from what public accountants have provided to their clients for years in what are generally referred to as management letters. The subject matter is extended, and a report on a governmental activity will usually receive much wider distribution than is customary with public accountants' letters to the management. The difference is much more a matter of coverage and emphasis.

FREQUENCY OF AUDITS

With regard to the question of whether efficiency-economy and program effectiveness audits must be conducted annually of all phases of city or county operations, the answer is a strong "No." It is contemplated that management audits will be made of the various local government functions on a cyclical basis so as to cover each function perhaps once each 3 years. Even in these cases, it is not necessarily assumed that the entire function be reviewed. Auditors will probably be able to pinpoint trouble areas and then review these areas in depth.

COST OF BROAD-BASED AUDITS

We think it is reasonable to assume that the broader scope audit will cost more than the traditional financial audits. But hopefully the benefits will also be much greater. You must remember that one of the auditor's primary purposes will be to identify areas where the organization's operations can be improved. You should also recognize that your costs will depend somewhat on how specifically you can define for

the auditors the specific function you want examined and the specific issues you want the auditors to address.

Follow-on work

We believe that our statement of auditing standards will do much to help improve the quality of auditing of governmental activities. But publishing such a statement is only a part of the job--gaining acceptance of these standards and obtaining experience in audits of the scope contemplated is a much more difficult job and one that will require vigorous and concentrated attention for a long time to come.

Many members of your organization have expressed interest in our statement, as have many other organizations and individuals. So far about 55,000 copies have been distributed.

We are doing a great deal to publicize our audit standards and make it easier to understand them. For example:

- We have held conferences at which we explained the standards to Federal, State, and local officials and CPAs in the 10 Federal regions. Over 6,000 people attended these meetings.
- We are publishing a book of questions and answers on the standards, and we are considering publishing a sample audit report prepared in accordance with the standards.
- We have just about completed a model State audit statute and a model audit ordinance for use by governmental units that want to establish audit organizations to carry out the kind of advanced auditing that we recommend.
- We are conducting surveys into problem areas involving cooperation on auditing matters between the Federal Government and State and local governments.

National Intergovernmental Audit Forum

Another course of action that we are working on is the establishment of a National Intergovernmental Audit Forum. In recent years the amount of Federal financial aid to State and local governments has increased almost astronomically. This increase--and the related management and accountability problems--was a major factor in our decision to develop an expanded code of auditing standards.

Coordination of auditing efforts, however, between the Federal Government and State and local governments has been difficult to achieve. With the greatly improved communications, particularly with State auditors, that grew out of the process of developing our auditing standards statement, we have agreed to organize new machinery to improve coordination, avoid unnecessary duplication of auditing, promote intergovernmental reliance on auditing at different levels of government, promote training in auditing concepts and techniques in accordance with our auditing standards, and generally improve communications.

The National Intergovernmental Audit Forum is now being organized. Its members will consist of Federal, State, and local governmental auditors. We hope it will be a productive mechanism in the future.

We are also experimenting with the idea of establishing regional intergovernmental forums which would be located outside of Washington. The first one has been organized in the southeastern States.

GENERAL REVENUE SHARING

I would like to turn my comments now to another area in which I know you also have a vital interest--general revenue sharing.

The State and Local Fiscal Assistance Act of 1972, popularly known as the Revenue Sharing Act, which was passed last fall is one of the most significant pieces of fiscal legislation in the history of American federalism. It brought a new concept to intergovernmental fiscal relations. Under this 5-year program, administered by the Department of the Treasury, a total of about \$30.2 billion is being distributed to States, counties, and essentially all general-purpose units of local government. Revenue sharing has been a controversial proposal; the basic controversy centers around the wisdom of turning Federal revenues over to State and local governments without the multitude of controls customarily associated with Federal assistance programs.

The act gave GAO two tasks:

- First, to provide consultation to Treasury in establishing fiscal, accounting, and audit guidelines to be followed by recipient governments.
- Second, to review the work done by Treasury, the State governments, and the units of local government in order to assist congressional evaluation of compliance and operations.

In carrying out the first task, we were heavily involved in working with Treasury on the accounting and auditing sections of the final revenue-sharing regulations which were published this past April. I believe that the regulations,

although they are intentionally quite general, provide a reasonable framework for insuring accountability by State and local governments over the receipt and disbursement of revenue-sharing funds. In the final analysis, however, the extent to which accountability will actually be achieved under this program is largely up to you, as municipal financial officials.

All of us--but particularly officials such as you--need to do all we can to assure the public and the Congress that, on the basis of our observations, Federal funds are spent in accordance with the regulations, as well as economically and effectively. This is of vital importance, not only because of revenue sharing, but because the Federal Government can and should rely more heavily on State and local government in administering all Federal assistance programs. Revenue sharing is being viewed by many as a test of the integrity and responsibility of State and local government, and the experience of this program will no doubt have a direct impact on the success or failure of future attempts to place greater reliance on State and local administration of Federal assistance programs.

I believe that the audit is one technique which can go a long way toward assisting State, local, and Federal officials in their attempts to insure that revenue sharing is properly managed. We need carefully planned and executed audits which will (1) produce information to evaluate revenue sharing and (2) indicate whether the funds are being used economically, efficiently, and effectively. With this thought in mind, the

regulations encourage recipient governments to have their audits of revenue sharing performed in accordance with the audit standards that I mentioned earlier. I want to take this opportunity today to add my personal encouragement to each of you to give serious consideration to use of the standards in the revenue-sharing audits of your particular government.

GAO reviews of revenue sharing

The Congress will no doubt be interested in some type of overall evaluation as to whether the Federal funds were spent efficiently and contributed to the effectiveness of the State and local programs in which they were used. A crucial question is whether revenue sharing is more or less effective than the categorical aid approach. Though a definite answer may not be possible, the Congress will be seeking evaluative data to assist it in deciding whether revenue sharing should be expanded, modified, or discontinued, particularly as the present 5-year program nears expiration.

In anticipation of these congressional needs, we have started or have plans for reviews of several aspects of revenue sharing.

During the past 2 months, we have visited the 50 state governments and the District of Columbia and obtained information relating to the status of the \$1.7 billion that the States and the District received for calendar year 1972. We are now consolidating the information to enable us to issue a report to the Congress this summer. The report will include:

1. A summary of the States' plans for using the \$1.7 billion.

2. A breakdown of the planned and actual expenditures by functional categories, such as health, education, and recreation.
3. The total amount of funds invested and the amount of interest earned.
4. A discussion of problems in administration that were encountered or anticipated by State officials.

We have recently initiated a similar review that will cover the revenue-sharing activities of local governments. For purposes of this review, we will visit only 250 of the more than 36,000 counties, cities, and townships that are receiving funds. I might mention that our sample includes the 50 largest counties and the 50 largest cities as well as smaller jurisdictions. The report on this review is scheduled to be issued to the Congress this fall.

GAO auditors are also now working at the Office of Revenue Sharing in the Department of the Treasury to see how well it is carrying out its administrative responsibilities. The review work presently in process is designed to assess Treasury's distribution of the funds as well as the adequacy of the Bureau of the Census data used to determine the amounts allocated to State and local governments.

The Revenue Sharing Act directs Treasury to provide for reviews and audits necessary to insure that the State and local governments use the funds in accordance with the various restrictions in the act and the regulations. We plan to closely monitor and evaluate Treasury's compliance audit effort.

The Office of Revenue Sharing currently plans to have only a small audit staff (about 20 to 25 auditors). It is apparent that it would be physically impossible for such a limited staff to achieve the required degree and depth of audit coverage. Therefore Treasury plans to rely on the organizations that presently audit State and local governments to make the necessary compliance audits. We will be particularly interested in the guidance that Treasury gives to the organizations that will carry out the compliance audit work and the manner in which Treasury satisfies itself that these audits are adequately and competently conducted.

Our direction from the Congress to evaluate the revenue-sharing program also seems to call for broad studies which would indicate the impact that revenue sharing has on the Federal, State, and local relationships existing before the inception of the program. These studies could include such inquiries as:

- The impact that the program has on current efforts to reform local government through consolidation of conflicting jurisdictions and competing tax units.
- The extent to which revenue-sharing funds are used by State and local governments to provide tax relief to their citizens as opposed to increasing the level or quality of government services.
- Analyses of the effects that State changes to the local distribution formula have on the allocation of the funds within the States.

Audits and evaluations of the management, operation, and results of programs involving Federal assistance to State and local governments have been difficult. Methods for making

such audits have been elusive. The lack of a consensus with regard to national goals; the inability to agree on methods for measuring social or public benefits; and the absence of reliable, appropriate, and representative data have all contributed to the continuance of these difficulties.

INTERGOVERNMENTAL RELATIONS FUNCTION OF GAO

In our reorganization of last year, responsibility for carrying out all GAO efforts in intergovernmental relations activities, other than the audit standards project, was centralized in our General Government Division.

The Division is the focal point for interchange of information between GAO and individual State and local governments and related public interest groups on past, ongoing, and planned intergovernmental relations activities. Our staff members are available to provide information on current and past GAO work relating to intergovernmental matters and to furnish copies of GAO reports dealing with intergovernmental problems.

For example, our staff routinely furnishes the Washington-based public interest groups, such as the National League of Cities and the Council of State Governments, with copies of all GAO reports which deal with Federal programs affecting State and local government. In one case, we provided the major public interest groups with over 100 copies of our report entitled "Study of Federal Programs for Manpower Services for the Disadvantaged in the District of Columbia" for distribution to their constituents.

In another instance, in cooperation with the National League of Cities, we made available to individual cities copies of our study of the District's policy for establishing regulatory fees. During our study we had several discussions with officials of local governments and found them to be interested in the subject of our study because of the possibility of increasing their own local revenue. Since the establishment of fees to provide regulatory services is an activity common to most local governments, we contacted the National League of Cities to determine whether they would be interested in publicizing this report in one of their publications. The league agreed, and, in response to an article in the Federal Aids Bulletin, we received requests from nearly 100 cities, towns, and townships for copies of our report.

I think it is appropriate at this time to clarify how we perceive the intergovernmental relations function in GAO. In most cases, intergovernmental relations groups generally perform a public relations function or serve as a clearinghouse for dissemination of information. In GAO the intergovernmental relations function is much broader. We want State and local officials to know that our staff is available for inquiry on any matter dealing with Federal programs especially in areas of problems associated with program administration. This is especially important because the intergovernmental relations group is also responsible for conducting broad-based studies of Federal activities impacting on State and local governments.

Information and inquiries coming to us from State and local officials can form the basis for some of our detailed studies on the effectiveness of Federal programs. These studies will deal not only with assessing individual Federal programs, but rather with the system for delivering Federal assistance with emphasis on the State and local perspective on how Federal programs are administered. Let me illustrate with a few examples of studies that are now in process or will be initiated in the near future.

One study deals with assessing the accomplishments of Federal Regional Councils. We will not only examine the organization and structure of the Councils but will place special emphasis on ascertaining whether the Councils have been successful in simplifying and accelerating the delivery of Federal Assistance to State and local governments. We also are looking at the implementation of selected Office of Management and Budget circulars which impact on State and local governments. We are especially interested in the operation of the clearinghouse systems under Circular No. A-95 and the regional information systems under Circular No. A-98. Another current study deals with Federal payments in lieu of taxes to local governments. This is a complex subject as there are quite a number of individual programs authorized under separate legislation which provide for such payments. An important element of the study is measuring the real effect that the presence of a Federal facility or activity has upon the community in which it is located.

In the near future, we plan to study the Federal grant-in-aid system from the perspective of States and cities, to identify the problems experienced with the system by its recipients and to explore possible solutions.

The area of intergovernmental relations is indeed a complex one but nevertheless one of importance. In view of the increasing number of grant-in-aid programs, the resultant difficult problems of administration, and our desire and need to move toward broader areas of inquiry, we believe that, in addition to reviewing and evaluating individual programs, we must go further and consider problems and opportunities for improvement from a broader viewpoint. We must view the responsibilities of the Federal, State, and local governments in the grant-in-aid area from the perspective of the overall part they play in financial management with respect to a large portion of the Federal budget.

In conclusion, I would like to say again how much I especially appreciate the opportunity to be here with you this morning. I would like to leave you with a few suggestions that I believe will help make our cooperative ventures more productive.

First, encourage your managers and your auditors to view auditing as a valuable tool to effective management of municipal programs.

Second, stimulate your councils to be as specific as possible in defining program objectives, goals, and performance criteria for all municipal programs.

Third, promote the development of progressive audit programs, including putting sufficient resources into training audit staffs.

Fourth, make every effort to insure the efficient use and proper handling of revenue-sharing resources.

Fifth, feel free to discuss your problems with us and, perhaps more importantly, your proposals for solving the problems.

Let me close by assuring you that both our audit standards and intergovernmental relations organizations should be considered by you and your staffs as available resources in carrying out your very important responsibilities.